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File: USPT

Jul 20, 1999

DOCUMENT-IDENTIFIER: US 5926800 A

TITLE: System and method for providing a line of credit secured by an assignment of a life insurance policy

Brief Summary Text (6):

A number of previously known methods address these difficulties by exploiting life insurance policies held by the elderly or the terminally ill. One of these is the Accelerated Death Benefit Option ("ADBO") offered by some life insurance companies to permit the insured an opportunity to "cash out" his death benefits under certain restrictive conditions. Under ADBOS, the insurance company offers to pay to an insured while still living the death benefits payable under his or her life insurance policy less a discount to reflect an interest charge. ADBOs are governed by state insurance laws and regulations. In 1991, the National Association of Insurance Commissioners (NAIC) adopted an Accelerated Benefits Model Regulation which has been adopted by many states. Following the NAIC model, many state regulations restrict ADBC to policyholders with less than twelve months to live and limit the interest rate used to calculate the applicable discount. In practice, most insurance companies only offer the option to insureds with six months or less to live, limit the ADBO to a portion of the full face value, and require that the policyholder obtain a doctor's certification of his or her limited life expectancy. ADBOs present several drawbacks. First, as a practical matter, doctors are often reluctant to provide the certification required by state regulation. Second, for federal tax purposes, it is currently unclear whether ADBO payments qualify as insurance proceeds payable under an insurance contract which are excluded from income or are fully taxable. The IRS has issued proposed regulations which exclude from income "qualified accelerated death benefits" which are defined as certain accelerated payments to insureds with illnesses expected to result in death within twelve months. In addition, similar legislative proposals have been made in Congress. Until any of those regulatory or legislative proposals are finalized, ADBOs should be treated as fully taxable income. Third, use of an ADBO yields proceeds that may violate the "limited assets" test used to determine eligibility for Medicaid, hospice care, and supplemental income benefits.

Brief Summary Text (7):

A second known method of providing funds consists of loans offered by life insurance companies to their existing policyholders. A first drawback with this method is that, by state regulation, the loan amount is limited to the cash surrender value of the policy, not the policy's face amount. This requirement imposes a severe limitation on policyholders having little cash value in their policies. The extreme case is presented by term or group insurance policies which, having no cash surrender value, are ineligible for policy loans of this sort. Even in the best case, cash surrender values rarely exceed 50% of the policy's face amount. A second drawback of extending a loan based on an existing life insurance policy is that state regulation also caps the interest rate that insurance companies may charge for such loans. The fact that these regulated rates are generally below market rates of return presents a significant disincentive for insurance companies to offer the loans.

Brief Summary Text (8):

A third known method of offering funds to patients having short life expectancies

is practiced by companies known as "viatical settlement companies". These companies purchase policies from terminally ill patients at a discount to their face value often from 20% to 50%. Upon the insured's death, the viatical settlement company collects the full face amount of the insurance policy. The financial return to the viatical company is based on the discount used to determine the purchase price and the length of time until the insured dies. There are several disadvantages to the insured from selling a policy to a viatical company. First, the transaction is a sale of the policy and not a loan against the policy, and the proceeds constitute taxable income to the insured. Second, unlike a loan, if the insured dies quickly, the viatical company collects a windfall as no residual benefits are owned to the insured's estate. Third, as with ADBO's, sale to a viatical company yields income that may result in violations of the governmental needs-based tests, thereby rendering the patient ineligible for various benefits. Many states are currently enacting regulation based on the NAIC Viatical Settlements Model Regulation to impose limits on the discount rates used (by imposing minimum percentages of face value based on life expectancies) and to impose licensing and reporting requirements.

Brief Summary Text (17):

It is yet another object of this invention to enable the provider to earn a market rate of return in extending the line of credit and avoid the limits on interest imposed by state insurance regulations and proposed tax regulations.

Detailed Description Text (54):

If the policyholder lives a long enough period of time, at some point the total premiums, interest, and fees may grow to the point where the accumulation exceeds the policy's face value. For example, a policy with a higher annual premium represents a larger risk than a policy with a lower premium. Since the policyholder's interest in the proceeds of the policy is reduced, the company would assume the burden of paying the premium to maintain the value of its collateral. The premium payment would be added on to the balance of the loan. For individual that live significantly longer than the average, these premiums would increase the risk that the loan balance exceeds the face value of the policy. In this case (the "deficiency regime"), the life insurance proceeds will be insufficient to fully reimburse the provider for the total amount it has advanced under the line of credit. Once the deficiency regime obtains, the provider's return is equal to in the deficiency regime: ##EQU3## where LC.sub.0 is the amount of the line of credit extended,

Other Reference Publication (8):

Poe et al., "Imminent death and accelerated benefits: The regulatory environment", Journal of Insurance Regulation v12 n1 PP.:28-56 Fall, Dialog File 485, Acc No. 00428157.

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